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Differentiation in ACP-EU Cooperation

Implications of the EU's Agenda for Change for the 11th EDF and beyond

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About this paper

This paper presents an independent analysis aimed at promoting and informing the (ongoing) discussions on the application of the differentiation principle noted in the EU's recently adopted Agenda for Change to ACP countries for the 11th European Development Fund (EDF) and beyond.

This paper acknowledges that there is an ongoing debate on the desirability of differentiation from a development-effectiveness point of view.[1] The paper itself does not go into these debates but instead takes the Cotonou Partnership Agreement as a starting point and examines to what extent recent EU policy developments may influence the use of the differentiation principle described in this Agreement.

The paper seeks to frame the discussions on the principle of differentiation in a historical context and links it to the decisions on allocation criteria noted in the Cotonou Partnership Agreement. It also compares the European Union's proposals to existing differentiation policies in EU Member States' bilateral development policies. The paper subsequently provides a more detailed analysis of the potential implications and expectations of the application of the Agenda for Change's differentiation principle for ACP countries and stresses the need for frank, proactive discussions between the different stakeholders involved.

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The authors are also grateful to all ACP and EU stakeholders consulted in the context of this paper for their most useful inputs and comments. The views expressed in this paper are those of the authors and should not be attributed to any other person or institution.

[1] These debates are informed by overall policy discussions as to whether Official Development Assistance (ODA)

Acronyms

ACP	Africa, Caribbean and Pacific
CoC DoL	Code of Conduct on Division of labour in Development Policy
CPA	Cotonou Partnership Agreement
DAC	Development Assistance Committee of the OECD
DEVCO	Directorate-General for Development and Cooperation - EuropeAid
DCI	Development Cooperation Instrument
DFID	Department for International Development
DoL	Division of Labour
EBRD	European Bank for Reconstruction and Development
ECDPM	European Centre for Development Policy Management
EC	European Commission
EDF	European Development Fund
EEAS	European External Action Service
EIB	European Investment Bank
EP	European Parliament
EU	European Union
EVI	Economic Vulnerability Index
FDI	Foreign Direct Investment
FTAs	Free Trade Agreements
GDP	Gross Domestic Product
GNI	Gross National Income
GNP	Gross National Product
HDI	Human Development Index
HIC	High Income Country
HPC	High Performance Computing
LDCs	Least Developed Countries
LIC	Low Income Country
LMIC	Lower-Middle Income Country
MDG	Millennium Development Goal
MFF	Multi-annual Financial Framework
MIC	Middle Income Country
MS	European Union Member States
NIP	National Indicative Programme
ODA	Official Development Assistance
OECD	Organisation for Economic Cooperation and Development
PPP	Public-Private Partnership
RIP	Regional Indicative Programme
UK	United Kingdom
UMIC	Upper-Middle Income Country
UN	United Nations
USD	United States Dollars
WTO	World Trade Organization

Executive Summary

Introducing EU Differentiation Policy and Practice

1. This paper analyses the European Union's (EU) recent policy discussions of applying the principle of differentiation to development cooperation and on this basis reviews potential implications for the African, Caribbean and Pacific (ACP) group of countries in relation to the 11th European Development Fund (EDF) and beyond. It acknowledges that there is an ongoing debate on the desirability of differentiation from a development-effectiveness point of view. The paper itself does not enter into this debate, but instead takes the Cotonou Partnership Agreement as a starting point to examine the extent to which recent EU policy developments may influence the application of the differentiation principle described in this Agreement. The need for dialogue on this issue is emphasised throughout.

2. **The principle of differentiation is not new in ACP-EU development cooperation**. The European Commission has historically applied differentiated levels and methods of development cooperation to different countries and country groupings. The adoption of the Cotonou Partnership Agreement in 2000 introduced needs and performance criteria to determine the allocation of funds from the EDF to countries and regions. As per this agreement, 'differentiation' became a fundamental principle of the ACP-EU partnership, which was a key change compared to the previous Lomé Conventions that determined allocations on an 'entitlement' basis.

3. **At the level of EU Member States, one of the major arguments for differentiating bilateral development assistance in recent years has been the shift towards a more focussed and development-oriented approach to country-selection**. Incentives to reduce the number of partner countries are therefore often rooted in the objectives of concentrating efforts and moving away from a situation in which post-colonial relations, geopolitical strategies and commercial interests dominated the decision-making on bilateral programming. However, such non-developmental considerations do not disappear entirely.

4. **An analysis of the five largest EU donors confirms three things**. First, the official criteria for country selection as used by the five countries are remarkably similar, and it often remains unclear how the criteria are interpreted and what their respective weight is in relation to one another. Second, they show that the official criteria for country-selection are i) not always exclusively development-oriented and ii) are far from the only decisive drivers behind the selection of partner countries. Third, despite an elaborated policy framework on a division of labour between the European Member States, decision-making on differentiation has remained a fundamentally sovereign matter. **Differentiating development assistance among partner countries should go hand in hand with a complementarity-based division of labour in order to be development-effective**.

5. In view of evolving global trends (e.g. the changing global economic landscape, the altering geography of poverty and the Eurozone crisis), the European Commission (EC) undertook a consultation in 2010 on EU development policy that resulted in a policy proposal for an **'Agenda for Change'**. This proposal was endorsed by EU Ministers for Development Cooperation in May 2012 and stresses the need to strengthen differentiation by optimally adapting the policy mix, as well as the type and level of assistance to circumstances in partner countries and regions. In this light the

EU **proposes to focus its development cooperation efforts on countries most in need where the greatest impact would be achieved**.

6. **Differentiation will unmistakeably affect ACP-EU development cooperation more so going forward than it has done in the past.** Efforts to apply the differentiation principle in EU development cooperation should be informed by frank discussions and general agreement among decision-makers, particularly on credible alternatives for bilateral grant aid or 'destinations' of differentiation.

Differentiation in the ACP

7. This paper examines to what extent and in which ways the principle of differentiation, in the spirit of the EU's Agenda for Change and as proposed by the EC for the Development Cooperation Instrument (DCI), could apply to ACP countries under the Cotonou Agreement. For this purpose **three types of differentiation** as promoted by the Agenda for Change were distinguished:

- **Differentiated mix of policies and instruments:** The Agenda for Change calls for the use of an optimal mix of policies, approaches and instruments adapted to countries' development situation. This fits the spirit of the Cotonou Agreement, which covers not only development assistance but also involves the trade and political dimensions of the ACP-EU partnership. Furthermore, during the 2010 revision of the agreement, the two parties agreed to promote the search for innovative financing mechanisms and the levering of private and public sources for development funding.

- **Differentiated level of development assistance:** The Agenda for Change proposes to differentiate resource allocations across countries and regions on the basis of i) country needs), ii) capacity, iii) country commitments and performance and iv) potential impact. The Cotonou Agreement allows for differentiation levels of development assistance, but only recognises needs and performance criteria. Nevertheless, the Commission's proposal for the DCI reveals that 'capacity' and 'potential impact' indicators are quite similar to certain performance indicators that guided the allocation of the 10^{th} EDF for ACP – EU cooperation in 2007-2013 (e.g. economic growth, Foreign Direct Investments or FDI, aid dependency). Hence, the Cotonou Agreement gives considerable space to apply differentiated levels of development assistance as promoted by the Agenda for Change.

- **Differentiated eligibility for development assistance:** The Agenda for Change proposes not only to reduce, but also to fully phase out bilateral development grant assistance to countries in middle- or higher-income categories. Applying this to the DCI, the EC has proposed, in principle, to discontinue bilateral assistance to upper middle-income countries (UMICs) and countries representing more than 1% of the world's Gross Domestic Product (GDP). Views differ strongly on the applicability of this approach under the Cotonou Agreement. Some consider this is in line with the agreement, while others argue that Cotonou allows differentiation in the *level* of funding but not in *access* ('yes' or 'no') to funding. The paper notes that universal access ('yes' for all) could still allow for considerable differences in allocation levels for individual ACP countries, with some countries receiving negligible amounts.

8. The Cotonou Agreement could thus be argued to provide space for each kind of differentiation noted in the Agenda for Change. However, it is important to remain conscious of the fact that **applying differentiation to ACP-EU cooperation requires a consultative approach, in line with the spirit**

of the Cotonou Agreement. As the EDF is governed by a legally binding international agreement, it is fundamentally different from the DCI.

9. Nevertheless, the authors have simulated the results of applying the Commission's DCI proposal for differentiation to the ACP for the sake of discussion. In doing so, the Commission would in principle **graduate UMICs** according to the list of Overseas Development Assistance (ODA) recipients from receiving bilateral assistance. In addition to the 3 High-Income Countries (HICs)[2] which currently receive funding through the 10th EDF, this principle would apply to a further 18 ACP countries leading to a total of **21 ACP countries under the EDF that could be considered as 'prime candidates' for graduation**.[3] This would concern mostly countries from the Caribbean and the Pacific, but also some African countries such as Botswana, Mauritius and Namibia.

10. **It is likely that the European External Action Service (EEAS) and the Commission will not propose graduation for the period 2014-2020. Rather, they are likely to propose to reduce bilateral grants for higher income ACP countries on a sliding scale (i.e. a stronger application of the second type of differentiation compared to previous EDFs).** A comparison made of the 9th and 10th EDF indicates that ACP states that belong to the group of Least Developed Countries (LDCs) or Low Income Countries (LICs) received larger shares and increases in country allocations from the 9th to the 10th EDF than higher-income ACP countries. One could expect this trend to continue under the 11th EDF and applied more strongly in view of the Agenda for Change.

11. The EU indicates that it intends to use additional criteria beyond income to further differentiate partnerships. **The authors argue that the *type* of indicators is not likely to change a great deal; it is primarily the *weighing* of the indicators that will make a difference**. For example, if economic vulnerability will have considerably more weight under the 11th than the 10th EDF, then this will positively affect the allocation of development assistance to a number of ACP countries, particularly in the Caribbean, as many Caribbean Middle Income Countries (MICs) score high on the Economic Vulnerability Index (EVI). Emphasis in the Commission's proposals on income levels have left some concerned that Gross National Income (GNI) per capita will overshadow other relevant country characteristics. Indeed, many ACP stakeholders would stress the importance of giving sufficient weight to other criteria (such as vulnerability and fragility) to respond to differing needs hidden by income figures. These criteria have not been well-defined and hence concern an important basis for dialogue between the ACP and EU in preparation of the 11th EDF.

12. Nevertheless, past experiences from Member States underline that, even with well-developed comparison frameworks and indicators, **political considerations will ultimately continue to play a decisive role**, which in the case of the EU will be partly influenced by Member States' interests and lobbies by other stakeholders.

13. Beyond allocation issues, efforts will be required of both EU and ACP stakeholders to effectively increase the use of innovative financing mechanisms and strengthen cooperation in a broad range of policy areas, as promoted by the Agenda for Change and enshrined in the Cotonou Agreement.

[2] Funding to HICs is not counted as ODA.
[3] This excludes South Africa, as its bilateral cooperation with the EU is funded from the DCI, and Cuba, which has a particular arrangement for cooperation with the EU.

Conclusions and recommendations

14. While differentiation is not a new concept in ACP-EU relations, it is expected to evolve alongside changing EU political priorities for development cooperation. For ACP-EU relations this will affect the mix of policies and instruments and allocated levels of ODA. Though unlikely to occur in the current programming cycle, it may potentially lead to the graduation from bilateral assistance for some ACP countries after the expiration of the Cotonou Agreement in 2020. Whatever the case, the principle of differentiation (including through graduation) should be explicitly discussed, a need which has been expressed by both parties.

15. Beyond discussing the legal basis for graduation under the Cotonou Agreement, both the ACP and the EU stand to benefit from operational and practical reflections and exchanges on the best ways to apply differentiation in ACP-EU cooperation. In view of the Cotonou Agreement's overall objectives, parties have a shared interest in applying differentiation in a way that ensures maximum impact on poverty reduction and optimal mutual benefits from their cooperation along all dimensions and in the spirit of Cotonou.

16. An important component of the reflection and dialogue is to **define on what basis to differentiate**. It remains to be determined not *if*, but *how* other criteria beyond income, like vulnerability and fragility, can be taken sufficiently into account to respond to differing needs and ensure more effective 'tailor-made' ACP – EU cooperation.

17. In order to ensure a development-effective application of the differentiation principle in the 11th EDF, concrete proposals and evidence-based exchanges are needed from the EU and the ACP on **tools and 'destinations' for differentiation.** This would be helpful to move beyond general and rather theoretical discussions of defining optimal 'policy mixes' or use approaches to 'innovative financing' that tend to dominate the current differentiation debate.

1. Introducing EU differentiation policy and practice

This introductory section presents an overview of the historical context of differentation in the European Union's (EU) development cooperation and clarifies recent proposals for differentation of the EU's 'Agenda for Change'. A comparison is also made with approaches to differention of EU Member States (MS) that can inform the application of the differentiaton principle at EU level.

1.1. Historical context of differentiation in EU development cooperation

The principle of differentiation is not new in EU development cooperation. The European Commission (EC) has historically applied differentiated treatment for development cooperation with countries and country groupings over time. Perhaps the best known is the Africa, Caribbean and Pacific (ACP) group, which for a long period of time has been granted preferential access to the EU's market and receives large amounts of European development cooperation funding.

The EU has provided development assistance and trade preferences to the ACP in the context of the Lomé Agreements from 1975 up to 2000 from which non ACP countries were excluded. Development assistance under the successive Lomé Conventions was provided to ACP countries on an 'entitlement' basis and was not explicitly linked to countries relative needs and performance.[4]

The adoption of the Cotonou Partnership Agreement (CPA or 'Cotonou Agreement' from hereon) in 2000 marked a departure from this approach of entitlement-based aid by including needs and performance criteria to determine the allocation of funds from the European Development Fund (EDF) to countries and regions. The Cotonou Agreement also made such differentiated treatment explicit by labelling 'differentiation' as a fundamental principle of the ACP-EU partnership (which is discussed in more depth in Section 2.1).[5] The agreement furthermore recurrently notes the central role of dialogue and consultation in the ACP-EU partnership and cooperation.

The European Consensus on Development adopted in 2005 underlines that differentiation is a principle that will continue to be applied in EU development cooperation with ACP countries and beyond, as it identified differentiation as 'a necessity'.[6] The Consensus specifies that needs, strategies, priorities and assets shall be the criteria to ensure such differentiated 'tailor-made' cooperation with countries and regions. This means that the use of cooperation modalities and their intensity in a budgetary sense would vary according to the circumstances in partner countries and regions. The document reiterated the EU's priority towards supporting Least Developed Countries (LDCs) and Low Income Countries (LICs). Special considerations are noted for fragile states and donor orphans. Finally, the Consensus states that development assistance will continue to Middle Income Countries (MICs), and argues that a large number of the world's poor live in these countries and MICs have an important role to play in the provision of global public goods (e.g. countering climate change, promoting peace and security).

Another important aspect that informs the operationalisation of the EU's policy on differentiation is the entry into force of the Lisbon Treaty in December 2009, which altered the legal framework for EU development

[4] E.g. Article 281 of the Lomé Convention reads: *"Each ACP State shall obtain from the Community a clear indication of the total indicative programmable financial allocation from which it may benefit during that period as well as any other relevant information."* http://www.caricom.org/jsp/community_organs/epa_unit/Cotonou_Agreement_&_Lome4_lome4.pdf

[5] Cotonou Partnership Agreement, Article 2.

[6] European Union (2006), Article 57.

cooperation.[7] Whereas earlier treaties defined several objectives for the EU's development cooperation[8], Article 208 of the revised Treaty on European Union brought this down to one central objective: *"Union development cooperation policy shall have as its primary objective the reduction and, in the long term, the eradication of poverty"*. Although this article leaves considerable room for interpretation[9], the focus on poverty reduction makes it more difficult to engage in cooperation with richer third countries if there is no direct or explicit poverty reduction objective.

1.2. EU member states differentiation in bilateral development policy

Having examined the differentiation principle at EU level, we proceed with an analysis of how this principle has been applied at the level of EU MS. Annex 1 presents a brief overview of the policies on partner country selection and categorization in the EU's five leading donors in terms of absolute levels of Overseas Development Assistance (ODA). Identified practices and considerations driving the process of differentiation at the MS-level proved useful in view of anticipating further differentiation of development assistance within the EU's geographic programmes.

At MS-level, more so than at the level of the EU, moving towards a more focussed and development-oriented approach to country-selection have been among the major arguments for differentiating direct development assistance. As a result of Cold War geostrategic logic as well as (post-)colonial ties, most leading EU donor agencies over time established a network of bilateral partnerships that simply became too extensive and too heterogeneous to be managed effectively. Incentives to reduce the number of partner countries are therefore often rooted in the objectives of concentrating efforts and moving away from a situation in which post-colonial relations, geopolitical strategies and commercial interests dominated the decision-making on bilateral programming, while in practice such non-development considerations do not disappear, as illustrated below.[10] Whereas Member States initially mainly focused on the third type of differentiation introduced in section 1.2, i.e. differentiation by eligibilty, in more recent years countries like Sweden and the Netherlands have operationalised policies that divide partner countries in different groups/profiles as a basis for differentiating in terms of mixing policies and instruments.

Although multilateral aid flows have been shown to become more sensitive to the Millennium Development Goals (MDGs), going to those that need it most, bilateral efforts have so far remained largely behind on this trend.[11] In the case of the top five EU donor countries, findings confirm that the official criteria for country-selection are i) not always exclusively development-oriented and ii) are far from the only decisive drivers behind the selection of partner countries. In Germany for instance, recent analysis of the country's geographical concentration shows that, although development objectives are indeed key features in the donor agency's selection process, they are far from decisive. Other variables such as population size, path dependency and the influence of donor agency interests play a key role as well.[12] Historical ties also add an additional parameter to the game, particularly in donor countries with a colonial past such as France

[7] For a detailed analysis of the implications of this Treaty for EU development cooperation, we refer to van Seters & Klavert (2011)
[8] Article 177 of the 1992 Maastricht Treaty which formed the legal basis for EU development policy until the entering into force of the Lisbon Treaty in December 2009 identified the following three objectives for European Community development policy: (1) to fight against poverty in developing countries; (2) to enhance the social and sustainable development of developing countries, particularly the most disadvantaged among them; and (3) to further the integration of developing countries into the world economy.
[9] It should be noted that the European Consensus on Development provides a detailed and multi-dimensional definition of what the EU considers as 'poverty'.
[10] Alesina & Dollar (2000) and Berthelemy (2006)
[11] Hailu & Tsukada (2012)
[12] Faust & Ziaja (2012)

and the United Kingdom (UK). In the latter case, a criterion defined as 'a strategic fit with UK policies' allowed the Department for International Development (DFID) to focus some 30% of its ODA-budget on war torn or unstable countries.[13] This led some stakeholders to raise concerns about a 'securitization of aid'.[14] Not only foreign policy interests affect the distribution of aid resources. In the case of the Netherlands, the explicit ambition to invest specifically in those policy themes and partner countries where Dutch commercial interests are at stake[15] urged the Organisation for Economic Cooperation and Development (OECD) to warn the country in its Development Assistance Committee (DAC) Peer Review that development objectives should remain paramount.[16]

The overview of MS's policies in Annex 1 shows that the official country selection criteria for bilateral assistance as used by the five MSs are remarkably similar. In some cases, concerns have been raised about the apparent random use and multi-interpretable nature of the criteria.[17] Indeed, it remains often unclear how the enlisted criteria are interpreted and what their respective weight is in relation to one another. A lack of transparency is the overall key weakness and where transparency is poor and selection formulas remain unclear, interests other than development can have more impact on the distribution of aid resources.[18]

Besides as a means to enhance development-orientation in country-selection procedures, differentiation at MS-level has also been defended as part of the global agenda for aid effectiveness. Arguably, national donors' geographic and sectoral concentration creates leeway for a more coordinated and results-oriented approach, increasing quality and development effectiveness.[19] Whereas differentiation may not be a new phenomenon, one cannot deny that ever since the 2008 financial crisis, a significant number of EU MS governments have reviewed their bilateral outreach in a spirit of cost-effectiveness and in line with decreasing budget allocations to their donor agencies. Over the past two years, there were 71 exit cases by EU MSs from 43 partner countries.[20]

Whereas the EU member states have thus developed their own bilateral operational policies and strategies to make independent decisions on differentiation, they have also engaged in international discussions relating to the promotion of aid effectiveness in which they committed to taking such decisions in a coordinated manner. Box 1 presents some analysis of the EU's Code of Conduct on Complementarity and Division of Labour, an attempt that sought to promote coordinated decision-making on differentiation by graduation.

Box 1: Differentiation through coordination? Experiences of the EU's Code of Conduct on Division of Labour

A key condition for differentiation to be development-effective is a close dialogue and a reasonable division of labour between donors. On this matter, the European Council adopted a voluntary EU Code of Conduct on Division of labour in Development Policy (CoC DoL) in May 2007. The CoC aims to address problems of duplication, orphanage and *donor congestion*. In doing so, the EU took the lead in coordinating the bilateral development efforts of its MSs: time had come to decide "*Who does what*". To better organise the division of labour (DoL) in a partner country (in-country) or between countries (cross-country), coordination between donors was to be done alongside the principles of

[13] See DFID (2011) and http://www.dfid.gov.uk/What-we-do/Key-Issues/Governance-and-conflict/
[14] Wild & Elhawary (2012)
[15] The Netherlands Ministry of Foreign Affairs (2010)
[16] OECD (2011)
[17] Schulpen, Habraken & van Kempen (2011)
[18] Faust (2011)
[19] European Commission (2011a)
[20] European Commission (2012)

complementarity, based on the comparative advantage of each MS donor, "*in order to achieve optimum use of human and financial resources*". [21]

Unfortunately, DoL has proven a rather difficult exercise so far. The overall weakness of the CoC has been its voluntary, "self-policing" nature. In the end, the road towards a better division of labour among EU donors is a political undertaking and, up to now, political commitment through the CoC was shown to be insufficient to ensure the actions agreed were undertaken.[22] In the end, it remains a country's sovereign decision whether or not to exit or enter a certain sector or country. Differentiating development assistance among partner countries should however go hand in hand with a complementarity-based DoL in order to be development-effective.

The EU's global presence has been recognised as key to the EU's value-added as a donor (e.g. in the European Consensus on Development), while studies such as the DAC Review have in contrast to this suggested further concentration. Currently MSs consider they can responsibly phase out cooperation in certain countries only because the EU is still there to fill the vacuum, but in the future this will be less the case if the EU concentrates more.

Differentiation has thus run as a thread through the EU's development cooperation for several decades, and has gained in prominence in recent years. Three years after the Lisbon Treaty has taken effect, several new developments have led to a reiteration and futher refining of the policy for differentiation, as described below.

1.3. Differentiation as part of the EU's 'Agenda for Change'

The principle of differentation has evolved in the context of several global developments in recent years, such as the imminent 2015 'deadline' for achieving the MDGs, the increasing influence of emerging economies indicating a changing global economic landscape; the altering geography of poverty within and across countries; commitments to new principles and configurations of effective development cooperation as captured in the Busan outcome document[23] and the international economic and Eurozone crises.

In view of these trends, the EC undertook a consultation in 2010 on EU development policy that resulted in a policy proposal[24] for an 'Agenda for Change'. This proposal was endorsed by EU Ministers for Development Cooperation in May 2012 and stresses the need to focus EU efforts on countries where the greatest impact would be achieved.[25] The Agenda for Change reflects Europe's attempt at reconciling its own internal economic challenges vis a vis its commitments as a major global player and partner in development cooperation and the global fight against poverty and achieving sustainable development. Among the policy prescriptions proposed by the EU in its Agenda for Change is that of differentiated development partnerships. Paragraph 18 of the EU Council Conclusions reads as follows:

> *"In future, the scope of the partnership and the corresponding resource allocation will be determined on the basis of: i) country needs (including economic and social trends, as well as vulnerability and*

[21] European Commission (2007)
[22] For example, a key element of the complementarity principle is the identification of each donor's value added. To do so, MSs were repeatedly encouraged to conduct a self-assessment of their strengths and weaknesses as a donor. These comparative advantages were to be endorsed by partner countries and recognised by other donors (Council of the European Union (2009)). So far, no such self-assessment exercises have been conducted, progress in sectoral, in-country concentration has been limited and as far as cross-country DoL is concerned, implementation has not moved beyond the exchange of information.
[23] See: http://www.aideffectiveness.org/busanhlf4/en/component/content/article/698.html
[24] European Commission (2011b)
[25] Council of the European Union (2012a)

fragility), ii) capacity, iii) country commitments and performance and iv) potential impact. This will allow the EU to adapt its support (the mix and level of aid) to the country's situation and progress in its commitment to and record on human rights, democracy and the rule of law, ability to conduct reforms and to meet the demands and needs of its people. This differentiation should lead to a more effective policy mix, appropriate aid levels, as well as efficient aid arrangements and the use of new and existing financial tools".

Teasing out what this implies concretely, by drawing from the Council Conclusions on the Agenda for Change and the Commission's proposal for the new Development Cooperation Instrument (DCI) for the period 2014-2020[26] that closley matches the policy proposals laid out in the Agenda for Change, one can identify three different types of differentiation that the EU seeks to implement:

1. **Differentiated mix of policies and instruments.** The Agenda for Change argues for the use of an optimal mix of policies, approaches and instruments adapted to countries' development situation. This implies furthering cooperation in other areas 'beyond aid' (e.g. trade, knowledge transfers, climate change etc.) and the use of innovative sources of financing (e.g. blending grants and loans and other risk-sharing mechanisms) when appropriate.[27]

2. **Differentiated levels of development assistance.** Resource allocations are to be differentiated across countries and regions on the basis of i) country needs), ii) capacity, iii) country commitments and performance and iv) potential impact.[28] Most emphasis is put on *needs* and *impact* as the EC and EU Member States have specified in their Agenda for Change that resources should be targeted at countries most in need and where they can have the greatest development impact in terms of poverty reduction. This focus implies that bilateral grant aid to more advanced countries will be reduced.[29] Priority will be given to LDCs, LICs and countries in crisis, post-crisis, fragile or vulnerable situations.[30] Differentiation according to *commitment and performance* may, but will not necessarily, lead the EU to allocate or disburse resources in tranches based on performance targets. This is already common practice in some aspects of EU external action – notably, it has been applied to the assistance given to the European Neighbourhood through the European Neighbourhood and Partnership Instrument, and has recently been explicitly termed 'more for more' in the revised European Neighbourhood Policy[31]. In relation to ACP countries, reference can be made to the MDG Contracts, where 30% of the 6-year assistance is tied to performance measurements[32], and the

[26] European Commission (2011c)
[27] Council of the European Union (2012)
[28] Further details of the four categories as proposed by the EC in the Agenda for Change are:
"(i) Country needs**:** assessed using several indicators, taking into account, *inter alia*, economic and social/human development trends and growth paths as well as vulnerability and fragility indicators.
(ii) Capacities**:** assessed according to a country's ability to generate sufficient financial resources, notably domestic resources, and its access to other sources of finance such as international markets, private investment or natural resources. Absorption capacities should also be considered.
(iii) Country commitments and performance**:** positive account should be taken of a country's investment in education, health and social protection, its progress on the environment, democracy and good governance, and the soundness of its economic and fiscal policies, including financial management.
(iv) Potential EU impact: assessed through two cross-cutting objectives: (a) Increasing the extent to which EU cooperation could promote and support political, economic, social and environmental policy reforms in partner countries; (b) Increasing the leveraging effect that EU aid could have on other sources of finance for development, in particular private investment." *Source: European Commission (2011).*
[29] Council of the European Union (2012a)
[30] Council of the European Union (2012b), Article 3.2
[31] European Commission (2011d)
[32] See: http://ec.europa.eu/europeaid/what/millenium-development-goals/contract_mdg_en.htm

Governance Incentive Tranche of the 10th EDF as specific initiatives applying differentiation by levels of assistance.

3. **Differentiated eligibility to development assistance.** The Agenda for Change proposes not only to reduce, but also to fully phase out bilateral development grant assistance to countries in middle- or higher-income categories, at least for those countries covered by the DCI (in Latin America, Asia, Central Asia, Middle East and South Africa). Indeed, the EC has proposed for the DCI, in principle, to discontinue bilateral assistance to upper middle-income countries according to the OECD/DAC list of ODA recipients and countries representing more than 1% of the world's Gross Domestic Product (GDP)[33]. Additional criteria (e.g. Human Development Index or HDI, Economic Vulnerability Index or EVI) can affect this graduation decision. Cooperation with these 'graduated' countries can continue to be funded through *thematic* programmes and instruments, such as the thematic programmes of the DCI and the newly proposed Partnership Instrument. [34] For these groups of countries, and as detailed in the DCI proposal[35], the Commission has proposed to apply this third type of differentiation to DCI countries. It should be emphasised that the Commission has not explicitly proposed applying the third type of differentiation to ACP countries under the 11th EDF.

Differentiation is demonstrably a core component of the EU's Agenda for Change, and will unmistakeably affect ACP-EU development cooperation more so going forward than it has done in the past. However, as specified above, differentiation can affect ACP-EU cooperation in a number of ways. Notably, the Agenda for Changes states that through "*comprehensive political and policy dialogue with all partner countries, the EU should define the most appropriate form of cooperation, leading to informed and objective decisions on the most effective policy mix, aid levels, aid arrangements and the use of new and existing financial tools, and building on the EU's own experience in managing transition."*

A unilateral application of the principle of differentiation is therefore not an option - efforts to apply the differentiation principle in EU development cooperation should be informed by frank discussions and general agreement among decision-makers, particularly on credible alternatives for bilateral grant aid or 'destinations' of differentiation. Section 2 analyses the legal basis and the implications of the application of the different types of differentiation to ACP in order to inform the discussions ahead.

[33] The EP's report on the DCI consequently has introduced amendments to ensure that aid to these countries is gradually 'phased out' rather than discontinued from one year to the next. See: http://www.europarl.europa.eu/oeil/popups/ficheprocedure.do?reference=2011/0406(COD)&l=en
[34] Ibid.
[35] South Africa is the only ACP country covered by the DCI. It is an Upper-Middle Income Country, but the European Commission has proposed to exempt it from graduation, without providing reasons for this exception.

2. Differentiation in the ACP

2.1. Strong legal basis for differentiation under Cotonou

The principle of differentiation is not a new concept for ACP-EU cooperation. In fact, Cotonou introduced differentiation as one of the fundamental principles underpinning the ACP-EU partnership, making it thereby an essential element of their cooperation.

A definition of this fundamental principle (of 'differentiation and regionalisation') provided by the Cotonou Agreement clarifies that it implies that:

> *"co- operation arrangements and priorities shall vary according to a partner's level of development, its needs, its performance and its long term development strategy. Particular emphasis shall be placed on the regional dimension. Special treatment shall be given to the least developed countries. The vulnerability of landlocked and island countries shall be taken into account. Particular emphasis shall be placed on regional integration, including at continental level"* (CPA, Article 2)

Article 2 therefore provides the legal basis for the application of the differentiation principle in the Cotonou context.

Given that differentiation is a broad concept, a closer look is required to determine if differentiation in the spirit of the EU's Agenda for Change and as has been proposed by the EC for the DCI could be applied to ACP countries under the Cotonou Agreement. This applicability can be examined in relation to the three types of differentiation introduced in Section 1.3.

1. **Differentiated mix of policies and instruments.** The Agenda for Change's call for the use of an optimal mix of policies, approaches and instruments adapted to countries' development situation fits the spirit of the Cotonou Agreement, which covers not only development assistance but also involves the trade and political dimensions of the ACP-EU partnership. Furthermore, during the 2010 revision of the agreement the two parties agreed to promote the search for innovative financing mechanisms and the leveraging of private and public sources for development funding.[36]

   In December 2011, the Commission published its proposals for the new instruments for external action under the 2014-2020 Multi-Annual Financial Framework (MFF). An overarching joint Communication by the European External Action Service (EEAS) and the EC published alongside further clarified that *"[d]ifferentiation will allow for different forms of cooperation such as blending grants and loans from international financial institutions, including the European Investment Bank. The increased use of innovative financial instruments should mobilise additional funding, including from the private sector. This will ensure maximum impact of EU spending in the context of a very tight budgetary situation."* A recent report distinguished three types of innovative finance (as noted in Box 2) that could be explored under this approach to differentiation. The EC currently places most emphasis on the first type and uses this type most.

[36] Cotonou Partnership Agreement, Article 21.

Box 2: Types of innovative financing mechanisms (Vanheukelom et al. 2012)

Three types of innovative financing mechanisms can be distinguished by their characteristics in terms of their public or private sources and their private or public uses.

- **Public Private Partnership (PPP)** mechanisms use public funds to leverage or mobilise private finance to support public functions such as infrastructure provision or service delivery (such as blending facilities, pursuing the complementary use of grants and loans, frontloading of ODA, raising funds on international capital markets by issuing bonds that are backed by long-term (legally binding) ODA commitments, and Official Support for Private Flows used to raise new revenues or to scale up or develop activities for development purposes).

- **Solidarity mechanisms** support public-to-public or sovereign-to-sovereign transfers of funds. This category includes global solidarity levies (i.e. taxes), but also covers debt conversions (or swaps). Under such debt-swap agreements, creditors agree to cancel a part of their claims on a debtor country in exchange for guarantees that a certain amount is spent on approved social or environmental programmes.

- Finally, **catalytic mechanisms** use public finance for market creation and promoting private sector development by reducing risks of private entry. These mechanisms could assist private investment in production of traded goods and services by offering domestic currency loans, quasi-equity investment capital and guarantees. These include financial guarantees, equity investments and callable capital.

2. **Differentiated level of development assistance.** The Cotonou Agreement allows for differentiation in development assistance allocations, as is illustrated by the fact that some ACP countries get more funding than others from the EDFs since 2000. Under the agreement, the level of resource allocations to each country or region is to be determined on the basis of 'needs' and 'performance'. These are two of the four categories of criteria put forward in the context of the Agenda for Change, which implies that the other two - 'capacity' and 'potential impact' - cannot be put forward as official allocation and differentiation criteria for EU development assistance to the ACP until the expiration of the Cotonou Agreement in 2020.

   However, the European Commission's proposal for the DCI[37] reveals that indicators proposed for these two additional categories of criteria of 'capacity' and 'potential impact' are quite similar to some performance indicators that guided the allocation of the 10th EDF for ACP – EU cooperation in 2007-2013 (e.g. economic growth, Foreign Direct Investments or FDI, aid dependency). Hence, the Cotonou Agreement gives considerable space to apply differentiated levels of development assistance as promoted by the Agenda for Change.

3. **Differentiated eligibility to development assistance.** A select number of interviews show that views differ on the applicability of this approach of differentiated eligibility under the Cotonou Agreement as proposed for the DCI (i.e. halting bilateral grant development assistance to upper middle-income countries). Some consider this is in line with the agreement, while others (ACP representatives in particular) argue that Cotonou allows differentiation in the *allocation* of funding but not in *access* to funding. Among the latter is ACP Secretary General Dr. Chambas, who has explicitly stated that graduation with respect to access to resources is not within the spirit of Cotonou.[38] It has been noted by others that universal eligibility could still allow for considerable differences in allocation levels for individual ACP countries with some countries receiving negligible

[37] European Commission (2011c)
[38] Secretariat of the ACP Group of States (2012)

amounts. Some observers suggest that symbolic amounts could however be hard to accept for the ACP Group, given that one of the objectives of the group as defined in the 1975 Georgetown Agreement is *"to promote and strengthen the existing solidarity of the ACP Group"*.[39]

Importantly, the application of any type of differentiation in ACP–EU cooperation must remain conscious of the specificities and the spirit of the Cotonou Agreement. In particular, as the Cotonou Agreement is a legally binding international agreement, any practical interpretation requires consultation. Furthermore, dialogue and consultation is a core feature of the Cotonou Agreement. In this sense the EDF is fundamentally different from the DCI. At the latest Joint ACP – EU Council of Ministers meeting in Vanuatu in June 2012, EU Commissioner for Development and Cooperation Piebalgs stressed the unique nature of ACP – EU cooperation guided by the Cotonou Agreement and, in this spirit, the need to engage the two parties in discussion on how the principle of differentiation should be applied under the next EDF. Nevertheless ACP representatives have expressed concern regarding the possible unilateral imposition of differentiation measures (particularly of the third type) by the EU.[40]

2.2. EU intentions to apply the Agenda for Change and its differentiation principle to the ACP

The EU seeks to implement the policy orientations defined in the Agenda for Change through the financial instruments for EU external action 2014-2020, which are currently being negotiated between the EU member states and responsible committees in the European Parliament (EP). One of the instruments proposed by the EC is the (11th) intergovernmental European Development Fund of €30 billion to support its relations with the ACP and the Overseas Territories.[41] The Commission has however proposed to keep this Fund outside the EU budget, and it is unlikely that it will be incorporated at this stage, meaning that the EP has no co-decision power on the overall arrangement.

The EU's intention to apply the Agenda for Change and its differentiation principle to the 11th EDF is confirmed in the instrument's impact assessment. On differentiation it specifically states that *"[t]he 11th EDF should allow for a more differentiated approach between beneficiaries, to respond to the specific situation of each country, taking into account their needs, capacities and performance, and potential impact of EU aid."* The impact assessment argues for a sharpened geographical focus and for the definition of alternative forms of cooperation and dialogue with more advanced partners.[42]

However, there is no specific reference to differentiation in the Commission's proposal for the internal agreement for the EDF was published in December 2011 and negotiations are still to kick off on the implementing and financial regulation of the fund (see Box 3 for details on the decision-making process of the EDF), so it remains to be defined how the EU will implement differentiation under the EDF and whether it will apply similar or different criteria as in the DCI.[43] Some sources have indicated that the EEAS, which leads on determining geographic development assistance allocations in collaboration with the Commission, considers proposing to enhance differentiation by reducing (but not 'graduating') bilateral assistance to ACP countries in middle- and higher income categories. A proportional reduction of country allocations for

[39] See: http://www.caricom.org/jsp/secretariat/legal_instruments/georgetownagreementonacp.jsp?menu=secretariat
[40] See for example Sanders (2012)
[41] The current 10th EDF has a budget of €22.99 billion for the current period 2008 – 2013. For a more detailed analysis of past EDFs in terms of absolute and relative sizes, please refer to Kilnes et al (2012)
[42] European Commission (2011e)
[43] Annex IV of the Cotonou Agreement was last revised in 2010 and includes more specific issues to guide the differentiation, including the vulnerability of economies.

some ACP countries could prepare the ground for phasing out development cooperation to these countries after 2020, when the Cotonou Agreement expires.

Box 3: EDF Decision-making process

In June 2011 The Commission presented a **Communication regarding the new EU Multiannual Financial Framework**, including a proposal to establish an 11th European Development Fund to finance ACP-EU development cooperation, outside of the budget. In December 2011 this was followed by a package of proposals from the Commission concerning the financial instruments for EU external action, including an **Internal Agreement for the EDF**. It presents the resources of the 11th EDF and how it is divided between broad sub-categories; it also includes some provisions on implementation and financial monitoring.

Discussions regarding this Commission proposal are underway in the Council. Unanimity is required for agreements related to the EDF, contrary to regulations for financial instruments under the EU budget that can be adopted by a qualified majority. Another difference is that **consent of the European Parliament is not required**, given the intergovernmental nature of the fund. The decision-making process will change considerably if it is decided to include funding for the ACP and Overseas Territories in the EU budget, which however seems unlikely to happen, judging from the current state-of-play of the negotiations.

After agreement on the internal agreement has been reached, the Council is expected to adopt the **Implementing Regulation** for the 11th EDF by unanimity, based on a proposal by the Commission and after consulting the European Investment Bank (EIB). This should be followed by the adoption of a **Financial Regulation** by a qualified majority, again based on a proposal from the Commission and after consulting the EIB and also the Court of Auditors.

Based on the Regulations, the **EDF Committee** will be formed. The European Commission and the EEAS will be invited to present their proposals for the chosen allocation methodology and criteria, which need to be approved in the Committee through a qualified majority. The Committee may at a later point be presented the specific allocations for approval, however this is not a requirement and in fact did not occur for the 10th EDF.

The EU will subsequently give the ACP a clear indication of the indicative programmable financial allocation from the 11th EDF from which countries and regions may benefit, an obligation under the Cotonou Agreement (Annex IV, Article 1.b). Within these boundaries, **the EU and ACP jointly agree on the forms of cooperation in the programming phase**, e.g. policy mix, financial instruments and aid arrangements, including the use of blending mechanisms. In short, the ACP has no official say over allocation decisions of the EDF across countries and regions as long as it these decisions do not breach any provision of the Cotonou Partnership, but they *are* co-deciders on how the financial envelopes are spent within a country or region.

Source: European Commission. 2011a and Cotonou Partnership Agreement (Annex IV)

2.3. Possible implications of differentiation for ACP countries

The ACP is a diverse group of states in many respects. As regards income levels, Gross National Income (GNI) per capita (current USD) ranged in 2010 between $180 (Democratic Republic of Congo) and $21.970 (The Bahamas). As such, the group comprises Low, Middle as well as High Income Countries (LICs, MICs and HICs) according to the OECD and World Bank classifications based on GNI per capita[44] (see Annex 2).

[44] See: http://www.oecd.org/dac/aidstatistics/daclistofodarecipients.htm and http://data.worldbank.org/about/country-classifications/country-and-lending-groups

Should the Commission's differentiation proposal for the DCI be applied to the ACP, then the Commission would in principle graduate Upper Middle Income Countries (UMIC) according to the list of ODA recipients from bilateral assistance. In addition to the 3 HICs[45] which currently receive funding through the 10th EDF, this principle would apply to a further 18 ACP countries leading to a total of **21 ACP countries funded under the EDF who could be considered as 'prime candidates' for differentiation**. It concerns mostly countries from the Caribbean and the Pacific, but also some African countries such as Botswana, Mauritius and Namibia (see the full list in Box 4). Views differ strongly on the applicability of such an approach, as indicated earlier.

Box 4: ACP Upper-Middle and High Income Countries that are not classified as LDCs

1. Antigua and Barbuda	8. Gabon	15. Palau
2. Bahamas*	9. Grenada	16. Seychelles
3. Barbados*	10. Jamaica	17. St Kitts and Nevis
4. Botswana	11. Mauritius	18. St Lucia
5. Cook Islands	12. Namibia	19. St Vincent and the Grenadines
6. Dominica	13. Nauru	20. Suriname
7. Dominican Republic	14. Niue	21. Trinidad and Tobago*
	* High Income Countries	

While this list provides a useful reference for discussions on differentiation, the expectation is that the EEAS and the Commission will not propose to introduce graduation for the 11th EDF. Rather, it is likely that they will propose for higher income levels for countries to lead to a smaller share of bilateral grants, but then only on a sliding scale.

At the same time, the EU would be expected to strengthen cooperation in other areas than development assistance and step up the use of innovative sources of financing. In discussing differentiation, both the EU and developing countries have in fact concentrated on the principle of 'receiving less or graduating from bilateral ODA', rather than pushing to develop new instruments and approaches in lieu of 'traditional' ODA – e.g. enhanced use of EU blending facilities – which in principle could be at least equally beneficial and potentially more developmental (see Box 5). **As long as the EU is not clear on the 'destination' of graduation, one can understand developing countries' sceptical stance towards this policy**.

Box 5: Blending mechanisms by the European Commission (adapted from Vanheukelom et al. 2012)

To prepare for increased use of blending mechanisms, the EC's Directorate-General for Development and Cooperation - Europeaid (DEVCO) has set up a new unit on financial instruments. It tries to promote better linkages with the European Investment Bank (EIB) and other European finance institutions (such as the European Bank for Reconstruction and Development or EBRD), EU Member State agencies and international finance institutions. These facilities blend grants from EU financial instruments (e.g. the EDF) with loans from multilateral and bilateral finance institutions. Strengthening the new blending instruments will help scale up support to private sector development, with potentially positive effects for developing countries.

The revised Cotonou Agreement specifically refers to blending mechanisms to support investment and private sector development. The use of these mechanisms to engage in developing countries (middle income countries in particular) and support private sector development is positive. This approach should be seen as a complementary tool for development, and should not replace grants with loans on a large scale, especially in low-income countries.

[45] Funding to Higher Income Countries is not counted as Official Development Assistance.

Own calculations by ECDPM (see Table 1) comparing the relative allocations of ACP states (as a percentage of total national and regional allocations) for the 9th and 10th EDFs show that generally speaking, ACP states that belong to the LDC or LIC categories received larger increases in country allocations under the 10th EDF compared to higher-income ACP countries. In view of the Agenda for Change one could expect this trend to continue and further increase under the 11th EDF.

Table 1: Overview of the 9th and 10th EDF allocations (NIPs & RIPs) per region and income category

Region	9th EDF Allocation	% of total	10th EDF Allocation	% of total	Difference	% increase	% of Increase
Africa	6520.8	92%	11316.5	92%	4760.7	74%	96%
Caribbean	353.8	5%	738.1	6%	93.3	109%	2%
Pacific	219.6	3%	306.6	2%	87.0	40%	2%
TOTAL	**7,094.2**	**100%**	**12,361.16**	**100%**	**4,941**	**100%**	**100%**
Category	**9th EDF Allocation**	**% of total**	**10th EDF Allocation**	**% of total**	**Difference**	**% increase**	**% of Increase**
LDC	5201.7	73.3%	9473.1	76.6%	4163.4	82%	84%
LIC	170	2.4%	383	3.1%	213.0	125%	4%
LMIC	1194.7	16.8%	1827.3	14.8%	414.6	53%	8%
UMIC	500.4	7.1%	637.8	5.2%	137.4	27%	3%
HIC	27.4	0.4%	40	0.3%	12.6	46%	0.3%
TOTAL	**7,094.2**	**100%**	**12,361.16**	**100%**	**4,941**		**100%**

Source: ECDPM own calculations

2.4. Evolving criteria for differentiation in EU development cooperation

Thus far, income levels and other income-based indicators appear to be the principal criteria for differentiation. However, income levels (both nationally and per capita) hide many differences in the state of development and the prevalence of poverty. In recognition of this, the EU indicates it intends to use additional criteria to further differentiate partnerships. In fact, even the draft DCI Regulation's proposal[46] to graduate UMICs from bilateral assistance goes beyond income levels alone. Firstly, this is due to the fact that the Commission proposes to graduate UMICs according to the list of recipients of ODA of the OECD DAC. This list excludes UMICs which are also LDCs, a UN categorisation based on GNI per capita, human assets and economic vulnerability. For the ACP, this only applies to Angola, as it is an UMIC but has such low scores on human assets and economic vulnerability that it also falls in the LDC category.[47] Secondly, the DCI proposal specifies that additional criteria relating to need and capacity will be used for graduation, such as the HDI, aid dependency, economic growth and FDI.[48]

Based on the Cotonou Agreement, the EC has for each EDF since 2000 proposed a greater variety of specific criteria to the Member States in the EDF Committee, which have been used for determining the

[46] European Commission (2011c)
[47] Equatorial Guinea is an ACP High Income country that falls into the LDC category.
[48] It should be noted that the DCI Regulation is prepared under the Ordinary Legislative Procedure, and that the EP's Policy Department has conducted a study on differentiation criteria (see http://www.europarl.europa.eu/committees/en/deve/studiesdownload.html?languageDocument=EN&file=75391) from which the Rapporteur has drawn and proposed an amendment to allow some Upper Middle Income Countries to continue receiving country-level allocations providing EU development cooperation can have significant potential leverage and that a number of criteria or met, including specific levels of human development and GINI-coefficient related thresholds. The amendments have been discussed and once the Parliament's first reading is concluded its proposals are discussed with the Council. For more information: http://www.europarl.europa.eu/oeil/popups/ficheprocedure.do?reference=2011/0406(COD)&l=en.

ACP countries' allocations. A note from the EC to the members of the Committee summarises the main changes made in the criteria for the 10th EDF compared to the 9th.[49]

> *"Three major changes have been introduced compared to the 9th EDF:*
> *(1) an enhanced focus on social indicators, reflecting the focus on poverty eradication, including the pursuit of the millennium development goals as the primary and overarching objective of the EU development cooperation;*
> *(2) 'the use of standard, objective and transparent resource allocation criteria';*
> *(3) a two step approach, whereby an initial indicative amount is communicated to the ACP States and regions at the beginning of the programming process based on quantifiable standard criteria, and a final indicative amount is notified at the end of the programming process which may include an additional "incentive tranche" based on complementary, more qualitative criteria related to governance and the reform agenda of the partner countries and regions."*

This detailed note describes how the criteria have been defined, what formulas have been applied and to what extent these differ from the ones used for the 9th EDF. The criteria as developed for the 10th EDF are in turn expected to be revised for the 11th EDF in line with the Agenda for Change, but this document will likely only be made public at a later stage once the allocations have been agreed to and communicated to the ACP. Table 2 presents an overview of differentiation criteria featuring in the allocation models of the 9th and the 10th EDF, as well in the Cotonou Agreement and the European Consensus on Development. Box 6 presents examples of criteria for differentiation that are put forward in different EU development policy documents, EU regulations and international agreements adopted since the start of the 10th EDF programming cycle, including the Agenda for Change and the DCI proposal. These different set of criteria will inform the allocation model for the 11th EDF.

Remarkably, the indicators noted in the DCI proposal are quite similar to the indicators that guided the allocation levels for the 10th European Fund for ACP-EU cooperation. Hence, the *type* of indicators is not likely to vary a great deal, even between instruments; it is primarily the *weighing* of the indicators that can make a difference. The EU seems to retain a strong focus on income levels, but its weight compared to other indicators to guide the differentiation outcome is unclear.

It is therefore impossible to predict the exact consequences for individual ACP countries of the EU's intention to strengthen differentiation with only the DCI proposal in hand. Merely if-then statements can be made. For example, *if* economic vulnerability is given considerable weight, *then* this will positively affect the allocation of development assistance to a considerable number of ACP countries, particularly in the Caribbean, as many Caribbean MICs score high on the EVI. Indeed, many ACP stakeholders stress the importance of taking other criteria beyond income, like vulnerability and fragility, sufficiently into account to respond to differing needs hidden by income figures. The Agenda for Change and the Cotonou Agreement support that view with specific references to other criteria. Nevertheless, emphasis in the Commission's proposals on income levels leave some concerned that GNI per capita will overshadow other relevant country characteristics.

[49] European Commission (2006)

Table 2: Categorised Commission criteria for differentiation as used for 10th EDF initial indicative country allocations (NIPs) (reproduced and expanded from EC 2006)

Cotonou Agreement	9th EDF	European Consensus on Development	10th EDF
Needs – allocation indicators			
- Population size - Income per capita - Social indicators (not specified) - Economic indicators (level of indebtedness, export earning losses and dependence on export earnings)	- Population size - GNP per capita (level of poverty) - Social development (life expectancy and education component of HDI)	- Population - Income per capita - Extent of poverty - Income distribution - Level of social development	- Population size - GDP per capita - Demographic dynamics (youth dependency) - AIDS prevalence rate - Human poverty index - Malnutrition
Needs – adjustment indicators			
- LDCs, vulnerable island and landlocked states - Special attention for countries dealing with the aftermath of conflict and natural disaster	Vulnerability (LDCs, island, landlocked and post-conflict countries)	- Countries in crisis, in conflict, disaster-prone - Priority to LDCs and other LICs, appropriate attention to LMICs - Specific focus on Africa	Vulnerability based on: - Economic growth fluctuations - Structural handicaps of LDCs - Enclave or landlocked countries
Performance – allocation indicators			
- Aid performance (use of resources and effective implementation of current operations) - Macroeconomic and sectoral policy performance - Progress in implementing institutional reform - Poverty alleviation, sustainable development	- Aid performance (absorption capacity, based on commitments) - Macroeconomic performance and structural adjustment - Political performance (based on armed conflict, human rights and institutional accountability) - Social development (notably life expectancy and education)	- Effective use of aid (aid absorption capacity) - Use of scarce resources - Political, economic and social progress - Good governance	- Aid performance (absorption capacity, aid dependence) - Macroeconomic performance (recent economic growth rates, environmental performance, external debt, reallocations at 9th EDF mid-term review) - Investment climate (external tariff protection, FDI, gross domestic capital formation) - Political performance (based on national programming dialogues) - Social performance (public spending on health and education divided by spending on military, progress on MDGs 2 and 5)
Performance – adjustment indicators			
	Envelop for non-programmable resources based on: - Economic vulnerability index - Share of Stabex/Sysmin in aid - HPC countries - Natural disasters and conflicts		

One striking conceptual point is that those indicators that are most accurate and readily available - income and population – are quite prominent in the allocation decisions informed by the Commission's note to the EDF Committee[50]. While seemingly objective, the same indicators could be used for multiple performance criteria or can be interpreted in different directions. For instance, a low income could be interpreted both as an indicator of low performance and as and indicator for a high need. When it comes to population, both a high and a low population can reflect country needs. Given this flexibility, it is important to stress that the legal basis for differentiation of the Cotonou Agreement (needs, performance) provides flexibility for setting political priorities and that, while the criteria themselves would at first sight suggest a rather absolute measurement, allocation criteria can be adapted to suit these political priorities. The need for consultative discussions on the selection, interpretation and usage of allocation criteria is therefore again underlined.

Box 6: Examples of differentiation criteria introduced in other EU external action policies post-10th-EDF

General System of Preferences (reformed in 2011)
GSP coverage will be reduced, leading to higher imports tariffs for: (1) all imports from Upper Middle-Income Countries (UMICs) that do not have a Free Trade Agreement with the EU (…) (Herbert 2012).[51]

European Neighbourhood Strategy
According to a policy of 'more for more', committed reformers in the EU's Southern and Eastern Neighbourhood would be awarded greater and broader EU support.

Agenda for Change
Country needs, capacities, country commitments and performance, potential EU impact (Paragraph 4)

Development Cooperation Instrument 2014-2020
Same as in Agenda for Change, additionally, criteria such as the Human Development Index, the Economic Vulnerability Index and other relevant indexes may be used to identify countries most in need (Article 3:2); upper middle income countries on the OECD/DAC list or countries whose GDP is greater than one percent of global GDP will be graduated (Article 5:2).

3. Conclusions and recommendations

This paper has analysed the development and operationalisation of the EU's principle of differentiation in development cooperation and on this basis sought to review the implications for ACP countries in relation to the 11th EDF and beyond.

Differentiation is not a new concept in ACP-EU relations. The Cotonou Agreement introduced differentiation explicitly as a fundamental principle, with needs and performance as key criteria (Art 2 and specification in Annex IV), and as such provided a strong break from the entitlement-based aid under the Lomé accords.

The proposed new legal instruments for managing the EU's external action budget that were put forward in December 2011 and the endorsement of the Agenda for Change by European Ministers for Development Cooperation in May 2012 further promote differentiated partnerships. For ACP – EU relations this will affect

[50] European Commission (2006)

[51] The debate over differentiation in the GSP was shaped by several factors specific to trade policy. Of these, WTO compatibility, stability for private sector operators, and the EU's own interest with regards the conclusion of FTAs with developing countries is worth mentioning.

the mix of policies and instruments and allocated levels of ODA. While there is currently little reason to presume that graduation from bilateral assistance will be introduced in the programming cycle covering the period 2014 – 2020, the principle should not be avoided in the discussions on differentiation, in particular as the possibility of graduation following the expiration of the Cotonou Agreement in 2020 cannot be excluded at this point. Discussions going forward should, however, not lose sight of the Cotonou Agreement amidst global trends and issues arising.

The unique nature of ACP-EU cooperation has been noted by Commissioner Piebalgs and various ACP representatives alike, as has the need for the various parties to engage in discussions on how the principle should be applied for the 11th EDF. Beyond discussing the legal basis for graduation under the Cotonou Agreement, both the ACP and the EU stand to benefit from operational and practical reflexions and exchanges on the best ways to differentiate to maximise impact on poverty reduction and mutually derive optimal benefit from their cooperation along all dimensions and in the spirit of Cotonou. A recent study commissioned by the EC from FERDI[52] and subsequently shared with the ACP Secretariat provides some impetus for dialogue, albeit at a late stage.

An important component of the reflexion and dialogue is **firstly to define on what basis to differentiate**. The criteria for differentiation for the 11th EDF, particularly of allocation levels, are not likely to deviate substantially from the ones that were used for the 10th EDF. Rather, it is the *weighing* of the indicators that is likely to change more. Judging from the proposals that are currently on the table, it is expected that the EU will give considerable weight to income per capita levels. It is widely recognized that income per capita hides many differences in development and prevalence of poverty. It remains to be determined not *if*, but *how* other criteria beyond income, like vulnerability and fragility, can be taken sufficiently into account to respond to differing needs and ensure more effective 'tailor-made' ACP – EU cooperation.

For this purpose, the EU should ensure 'standard, objective and transparent' criteria to determine which countries should receive what form of development assistance, as agreed in the European Consensus of Development. At the same time, stakeholders should beware that any allocation model provides flexibility for introducing political priorities, even if criteria themselves would at first sight suggest a rather absolute measurement. Hence, as illustrated by differentiation efforts in bilateral development cooperation of EU MS, non-development considerations are unlikely to be fully excluded.

Secondly, and crucially, concrete proposals and exchanges are needed from the EU and the ACP on **possible 'destinations' for graduation and corresponding tools,** in order to move beyond general aspirations of optimal 'policy mixes' or 'innovative financing' that tend to dominate the current differentiation debate. Much of that process will necessarily have to take place at country level. Depending on country characteristics, cooperation 'beyond aid' could be stepped up in areas such as research and development, education, protection of ecosystems etc. It could also involve exploring if and how ACP countries can benefit from ODA and non-ODA funding sources other than the 11th EDF in the period 2014-2020, such as thematic programmes of the DCI, the newly proposed Partnership Instrument and the Migration Fund. New regional cooperation modalities, including South-South and triangular cooperation, could also be considered. Any cooperation path chosen should be informed by lessons learned from past cooperation and be closely monitored.

[52] FERDI (2012)

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Annex 1: Overview of differentiation policies of the Top 5 European Union donors (see 1.2)

Top 5 EU government donors (2011[1])	Number of partner countries period 2000-2012 (Year of cuts)	Current selection criteria	Categorization in country profiles
Germany	**2011: 55- 46**	**1. Needs of the country 2. Significance and value added of German aid 3. Good governance and development orientation 4. Historical and political links 5. Protection of global public goods.**	**1. Poor, but well-governed countries 2. Fragile states 3. Emerging countries**
United Kingdom	**2011: 43 to 27**	**1. Development need 2. Likely effectiveness of assistance 3. Strategic fit with UK government priorities**	**No categorization in country profiles.**
France	**55 (of which 14 Priority Poor Countries)**	**Country selection is defended in narrative but not defined by preset criteria.**	**1. Sub-Saharan Africa 2. Mediterranean region 3. Emerging countries 4. Fragile states**
The Netherlands	**2010: 33 to 15**	**1. Income and poverty levels 2. Level of good governance 3. Prospects for achieving best results 4. Opportunities and interests of the ministries most closely involved (MFA and EA&I) 5. Capacity for progress in spearheaded areas**	**1. Low-income countries 2. Fragile states 3. Countries in transition**
Sweden	**2007: 125 to 33**	**1. Levels of poverty and needs 2. Aid-effectiveness expectations 3. Opportunities for democratic development 4. Value added of Sweden as a donor + "overall links"**	**1. Countries for long-term development cooperation 2. Countries in conflict and/or post-conflict situations 3. Countries in Eastern Europe**

[1] EC, *EU Accountability Report 2012 on Financing for development. Review of progress of the EU and its Member States*, Brussels: European Commission, July 2012, 55. http://ec.europa.eu/europeaid/what/development-policies/financing_for_development/documents/swp-199-main-report.pdf

Annex 2: Classification of ACP countries

ACP countries	Least-Developed Countries (LDCs)	Low-Income Countries (LICs)	Lower-Middle Income Countries (LMICs)	Upper-Middle Income Countries (UMICs)	High-Income Countries (HICs)
Angola	√			√	
Antigua & Barbuda				√	
Bahamas					√
Barbados					√
Benin	√	√			
Belize			√		
Botswana				√	
Burkina Faso	√	√			
Burundi	√	√			
Cameroon			√		
Cape Verde			√		
Central African Republic	√	√			
Chad	√	√			
Comoros	√	√			
Republic of Congo	√		√		
Cook Islands				√	
Cote d'Ivoire			√		
Cuba*				√	
Dem. Rep. Congo	√	√			
Djibouti	√		√		
Dominica				√	
Dominican Republic				√	
Equatorial Guinea	√				√
Eritrea	√	√			
Ethiopia	√	√			
Fiji			√		
Gabon				√	
Gambia	√	√			
Ghana			√		
Grenada				√	
Guinea	√	√			
Guinea-Bissau	√	√			
Guyana			√		
Haiti	√	√			
Jamaica				√	
Kiribati	√		√		
Kenya		√			
Lesotho	√		√		
Liberia	√	√			
Madagascar	√	√			
Malawi	√	√			

Mali	√	√			
Marshall Islands			√		
Mauritania	√	√			
Mauritius				√	
Micronesia			√		
Mozambique	√	√			
Namibia				√	
Nauru				√	
Niger	√	√			
Nigeria			√		
Niue				√	
Palau				√	
Papua New Guinea			√		
Rwanda	√	√			
Samoa	√		√		
Sao Tome and Principe	√		√		
Senegal	√		√		
Seychelles				√	
Sierra Leone	√	√			
Solomon Islands	√		√		
Somalia	√	√			
South Africa*				√	
South Sudan*			√		
St. Kitts and Nevis				√	
St. Lucia				√	
St. Vincent & Grenadines				√	
Sudan	√		√		
Suriname				√	
Swaziland			√		
Tanzania	√	√			
Timor-Leste	√		√		
Togo	√	√			
Tonga			√		
Trinidad & Tobago					√
Tuvalu	√			√	
Uganda	√	√			
Vanuatu	√		√		
Zambia	√		√		
Zimbabwe		√			
TOTAL	**41**	**28**	**26**	**22**	**4**
TOTAL LDC and other**	**n/a**	**26**	**12**	**2**	**1**

Source: UNDESA, OECD/DAC list of ODA recipients & World Bank Country and Lending Groups

* Cuba benefits from various trade agreements with the EU, but receives no ODA. South Africa currently receives ODA through the DCI but not through the EDF. South Sudan has received ODA funding through the Instrument for Stability, and is previewed to receive a country allocation for the 11th EDF.
** In the OECD/DAC classification, countries cannot fall into more than one category. Hence, where a country falls into the LDC category as well as an income-category, the OECD/DAC classification system would classify that country as an LDC.

Annex 3: Proportional distribution and relative growth of country allocations between 9th and 10th EDF

Country	9th EDF Allocation	% of total	10th EDF Allocation	% of total	Difference	% Increase	% of Increase
Angola	117	1.65%	214	1.73%	97	83%	1.96%
Antigua & Barbuda	2.6	0.04%	3.412	0.03%	0.812	31%	0.02%
Bahamas	3.9	0.05%	4.7	0.04%	0.8	21%	0.02%
Barbados	6.5	0.09%	9.8	0.08%	3.3	51%	0.07%
Belize	7.8	0.11%	11.8	0.10%	4	51%	0.08%
Benin	208	2.93%	334	2.70%	126	61%	2.55%
Botswana	69	0.97%	73	0.59%	4	6%	0.08%
Burkina Faso	275	3.88%	529	4.28%	254	92%	5.14%
Burundi	115	1.62%	188	1.52%	73	63%	1.48%
Cameroun	159	2.24%	239	1.93%	80	50%	1.62%
Cape Verde	32	0.45%	51	0.41%	19	59%	0.38%
Central African Rep.	106.5	1.50%	137	1.11%	30.5	29%	0.62%
Chad	202	2.85%	299	2.42%	97	48%	1.96%
Comoros	20	0.28%	45	0.36%	25	125%	0.51%
Congo	43	0.61%	85	0.69%	42	98%	0.85%
Dem. Rep. Congo	171	2.41%	514	4.16%	343	201%	6.94%
Cook Islands	2	0.03%	3	0.02%	1	50%	0.02%
Djibouti	29	0.41%	40.5	0.33%	11.5	40%	0.23%
Dominica	3.7	0.05%	5.7	0.05%	2	54%	0.04%
Dominican Republic	149	2.10%	179	1.45%	30	20%	0.61%
East Timor	18	0.25%	63	0.51%	45	250%	0.91%
Equatorial Guinea	13	0.18%	n/a	n/a	n/a	n/a	n/a
Eritrea	88	1.24%	122	0.99%	34	39%	0.69%
Ethiopia	384	5.41%	644	5.21%	260	68%	5.26%
Fiji	n/a	n/a	n/a	n/a	n/a	n/a	n/a
Gabon	34	0.48%	49	0.40%	15	44%	0.30%
Gambia	37	0.52%	76	0.61%	39	105%	0.79%
Ghana	231	3.26%	367	2.97%	136	59%	2.75%
Grenada	3.5	0.05%	6	0.05%	2.5	71%	0.05%
Guinea	158	2.23%	n/a	n/a	n/a	n/a	n/a
Guinea Bissau	62	0.87%	100	0.81%	38	61%	0.77%
Guyana	38.9	0.55%	51	0.41%	12.1	31%	0.24%
Haiti	n/a	n/a	290.95	2.35%	n/a	n/a	n/a
Ivory Coast	n/a	n/a	218	1.76%	n/a	n/a	n/a
Jamaica	90	1.27%	110	0.89%	20	22%	0.40%
Kenya	170	2.40%	383	3.10%	213	125%	4.31%
Kiribati	8.8	0.12%	12.7	0.10%	3.9	44%	0.08%
Lesotho	86	1.21%	136	1.10%	50	58%	1.01%
Liberia	50	0.70%	150	1.21%	100	200%	2.02%
Madagascar	267	3.76%	577	4.67%	310	116%	6.27%
Malawi	276	3.89%	436	3.53%	160	58%	3.24%
Mali	294	4.14%	533	4.31%	239	81%	4.84%
Marshall Islands	3.5	0.05%	5.3	0.04%	1.8	51%	0.04%
Mauritania	149	2.10%	156	1.26%	7	5%	0.14%
Mauritius	33	0.47%	51	0.41%	18	55%	0.36%
Micronesia	4.8	0.07%	8.3	0.07%	3.5	73%	0.07%
Mozambique	274	3.86%	622	5.03%	348	127%	7.04%
Namibia	73	1.03%	103	0.83%	30	41%	0.61%

Nauru	1.8	0.03%	2.7	0.02%	0.9	50%	0.02%
Niger	267	3.76%	458	3.71%	191	72%	3.87%
Nigeria	552	7.78%	677	5.48%	125	23%	2.53%
Niue	2	0.03%	3	0.02%	1	50%	0.02%
Palau	2	0.03%	2.9	0.02%	0.9	45%	0.02%
Papua new Guinea	131	1.85%	130	1.05%	-1	-1%	-0.02%
Rwanda	124	1.75%	290	2.35%	166	134%	3.36%
St. Kitts & Nevis	3.4	0.05%	4.5	0.04%	1.1	32%	0.02%
St. Lucia	4.5	0.06%	8.1	0.07%	3.6	80%	0.07%
St. Vincent & Grenadines	5	0.07%	7.8	0.06%	2.8	56%	0.06%
Samoa	20	0.28%	30	0.24%	10	50%	0.20%
Sao Tomé & Principle	9.4	0.13%	17.1	0.14%	7.7	82%	0.16%
Senegal	203	2.86%	288	2.33%	85	42%	1.72%
Seychelles	3.9	0.05%	5.9	0.05%	2	51%	0.04%
Sierra Leone	144	2.03%	242	1.96%	98	68%	1.98%
Solomon Islands	6.7	0.09%	13.2	0.11%	6.5	97%	0.13%
Somalia	50	0.70%	212	1.72%	162	324%	3.28%
Sudan	135	1.90%	n/a	n/a	n/a	n/a	n/a
Suriname	18	0.25%	19.8	0.16%	1.8	10%	0.04%
Swaziland	31	0.44%	63	0.51%	32	103%	0.65%
Tanzania	290	4.09%	555	4.49%	265	91%	5.36%
Togo	n/a	n/a	123	1.00%	n/a	n/a	n/a
Tonga	3.7	0.05%	5.9	0.05%	2.2	59%	0.04%
Trinidad & Tobago	17	0.24%	25.5	0.21%	8.5	50%	0.17%
Tuvalu	3.3	0.05%	5	0.04%	1.7	52%	0.03%
Uganda	246	3.47%	439	3.55%	193	78%	3.91%
Vanuatu	12	0.17%	21.6	0.17%	9.6	80%	0.19%
Zambia	240	3.38%	475	3.84%	235	98%	4.76%
Zimbabwe	n/a	n/a	n/a	n/a	n/a	n/a	n/a
	Total		**Total**		**Total**	**Average**	**Average**
	7094.2		**12361.2**		**4941.0**	**71%**	**1.45%**

Absolute amounts in millions of euros. ECDPM own calculations based on provisional country allocations for the 9th and 10th EDF, publicly accessible at http://ec.europa.eu/europeaid/how/finance/edf_en.htm and http://www.acp-programming.eu/wcm/.

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ECDPM was established in 1986 as an independent foundation to improve European cooperation with the group of African, Caribbean and Pacific countries (ACP). Its main goal today is to broker effective partnerships between the European Union and the developing world, especially Africa. ECDPM promotes inclusive forms of development and cooperates with public and private sector organisations to better manage international relations. It also supports the reform of policies and institutions in both Europe and the developing world. One of ECDPM's key strengths is its extensive network of relations in developing countries, including emerging economies. Among its partners are multilateral institutions, international centres of excellence and a broad range of state and non-state organisations.

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ECDPM organises its work around four themes:

- Reconciling values and interests in the external action of the EU and other international players
- Promoting economic governance and trade for inclusive and sustainable growth
- Supporting societal dynamics of change related to democracy and governance in developing countries, particularly Africa
- Addressing food security as a global public good through information and support to regional integration, markets and agriculture

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